Americans for Financial Reform

Statement for the Record
Senate Committee on Banking, Housing and Urban Affairs Hearing
Oversight of Prudential Regulators: Protecting Main Street, Not Wall Street
Wednesday, November 14, 2023 10 AM in 538 DSOB

Dear Chairman Brown and Ranking Member Scott, and members of the Senate Committee on Banking, Housing, and Urban Affairs,

In connection with the Committee's hearing on the oversight of prudential regulators on November 14, we write to advocate for the Fed, the OCC and the FDIC (hereafter the agencies) to finalize key rulemakings, particularly the Basel III Endgame and related reforms. We also advocate for the agencies to act with more urgency on key reforms that are necessary to prevent future financial crises. This includes moving forward on long awaited incentive compensation rules, making updates to their bank merger guidelines and, now that the Financial Stability Oversight Council's nonbank designation guidance is final, acting swiftly as members of the council to identify systemically important financial institutions for heightened scrutiny.

We ask the committee to support the agencies' finalization of the large bank Basel III Endgame proposal for stronger capital requirements. The alternative, allowing the largest banks to continue to operate in their current undercapitalized state, has real world economic consequences for individuals, communities, and 'real economy' businesses. Similarly, the ongoing delay in the agencies' updates to their bank merger guidelines, stalled compensation rules and still pending assessment of nonbanks for systemic importance, including climate related, continue to put Americans at risk of further financial crises.

The large bank capital proposal is an important step in the right direction to strengthen the large banks' capital cushions, which are key to their safety and soundness and, in aggregate, to maintaining a resilient financial system that can withstand severe shocks. Americans for Financial Reform (AFR) is not alone in thinking even higher capital standards are necessary, a view argued, for example, by the Minneapolis Fed's leadership in 2016.[1] Nonetheless, the current proposal represents significant progress, with provisions to finalize the Basel III Endgame and restore capital requirements for banks in the total assets band of $100 to $250 billion. We strongly urge the committee to support the agencies' finalization of the proposal in a way that maintains its key elements, undeterred by the bank lobby.[2]

[1] Minneapolis Fed, "The Minneapolis Plan to End Too Big to Fail: The Right Plan at the Right Time," Ron J. Feldman, Ken Heinecke, February 5, 2018.
[2] Tailoring Requirements for Domestic and Foreign Banking Organizations, https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf.

Higher bank capital requirements restrict how much the megabanks, in particular, can grow and engage in the riskier aspects of their business that drive greater higher returns, notably in their trading and investment bank operations. By opposing larger capital cushions, banks are trying to privatize the gains to their firm and socialize any losses. Additionally, higher capital undermines bank CEOs' shareholder oriented compensation arrangements. Instead of owning up to this, the biggest banks have produced a long list of reasons why the Basel III Endgame provisions should not be implemented. However, criticisms that the capital proposal will damage lending and the economy, undermine credit to BIPOC communities, and hurt climate initiatives do not hold up:

- Capital is not money locked away, prevented from supporting the economy, and higher capital levels will not lead to lower lending. Well-capitalized banks are less likely to default and have a greater cushion during economic downturns. Many studies have actually found that higher capital requirements support increased lending. Economists Stephen Cecchetti and Kermit Schoenholtz, coauthors of the leading textbook Money, Banking and Financial Markets, compiled data on how higher capital levels affected lending. Between 2013 and 2019, when bank capital levels were going up, the rate of overall credit availability remained robust—and that the portion of credit provided by banks, as opposed to nonbanks not subject to the new rules, actually went up. Banks made more loans even as they increased capital.
- Better-capitalized banks extend more credit during downturns, which is precisely when small businesses need it most. And capital requirements are not the reason banks do not lend sufficiently to communities of color. It is notable that many of the financial institutions and trade associations raising this issue are simultaneously suing to block implementation of small business lending data collection rules that would provide a much needed window on needs and problems in that market, including in particular for small businesses led by people of color and women.
- The agencies should make sure risk weights for home mortgages are appropriately weighted to address any genuine concerns, but the impacts of the proposal on home mortgage lending have been overstated. When the largest banks have had lower capital requirements, they have notably failed to serve Black and Brown communities,[3] and big banks are not the major originator of home loans to Black, Indigenous, people of color and other underserved communities; the major originators are non-banks such as Rocket Mortgage and Pennymac.[4]
- Mitigating climate change and ensuring financial stability are extremely important goals that must be tackled together - neither is possible without the other. We witnessed a preview of this issue last Spring with the failure of Silicon Valley Bank, a bank that served as an important climate investor. Our ability to mobilize capital to mitigate climate change is directly facilitated by the ongoing stability of our banks—or conversely limited by their failure. Some have proposed cutting the proposed risk

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[3] Boston Globe, *"Black and Brown Americans are chronically underbanked and unbanked. Here's why that matters,"* Daryl A. Carter, Updated September 11, 2023, https://www.bostonglobe.com/2023/09/11/opinion/black-brown-americans-are-chronically-underbanked-unbanked-heres-why-that-matters/.

[4] Insider Intelligence, *"2023 updates to our list of the top nonbank financial institutions and alternative lenders,"* https://www.insiderintelligence.com/insights/nonbank-alternative-lending-companies/.

weight for clean energy, carbon capture (in which captured carbon dioxide is mainly used for enhanced oil recovery), and certain biofuel tax equity finance transactions from 400% to 100%.

The regulators should differentiate and set appropriate risk weights for various types of equity exposures commensurate with their different risks. The OCC allowed national banks to treat a limited amount of tax equity finance as loan-like for capital purposes (up to 5% of their capital and surplus) in 2021, but they specifically required substantial enhanced prudential monitoring and approval for higher levels of concentration, in recognition of the potential risks. They wrote, upon raising the limit from 3% to 5%: "The OCC believes that a limit [on TEF transactions] is necessary but that the limit can be safely increased to five percent. Although TEF transactions will be subject to the legal lending limits on loans to one borrower…the OCC believes maintaining the aggregate transaction limitation will allow the OCC to assess how the authority is implemented and any safety and soundness concerns that may arise." If the OCC has since developed a better understanding of potential safety and soundness concerns, that should inform the setting of these risk weights.

These tax equity investments, in deals using project-generated cash flow and federal tax credits to finance energy initiatives, are not a reason to call for substantially lower capital requirements for the big banks. This space is dominated by the megabanks, such as JPMorgan and Bank of America, that are using others to advocate for policies that will ultimately help their own bottom lines. These deals are usually highly extractive, with the megabanks getting 15 cents for every dollar that developers have seen in tax credits that then went to lowering the megabanks' tax bills.

We are also deeply concerned that the agencies have yet to update their bank merger guidelines, which are essential to preventing the Americas' largest banks from getting bigger and avoiding excessive concentrations of risk in one firm. President Biden's Executive Order on Promoting Competition in the American Economy encouraged the banking agencies to review current practices and adopt a plan within 180 days.[5] However, over two years later, the agencies have not yet published new guidelines. The agencies have not gotten tougher in the ways needed to stop blithely approving mergers and start conducting robust assessments of bank mergers that properly scrutinize impacts on communities, market competition and financial system stability.

The agencies should move swiftly as members of the Financial Stability Oversight Council to identify systemically important nonbank financial institutions for heightened scrutiny. Now that the council has, quite rightly, reversed the previous administration's ill-conceived rule, approved in 2019, that made designations of large non-banks all but impossible, the Treasury-led council has the authority that it needs to start tackling new, and often growing risks in the financial system. AFR has long urged regulators to take this step.

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[5] White House Briefing Room Executive Actions, Executive Order on Promoting Competition in the American Economy,
https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/.

Lastly, we support the agencies' recently issued climate risk guidelines and are concerned about any efforts to undermine the integration of climate risk into bank supervision. AFR supports the agencies' work to address climate-related financial risk, especially as the world grapples with the dire effects of climate change. These efforts will lead to a more resilient financial system, a stronger economy, and put us on the path to effectively address the threats posed by a warming planet.

We close by respectfully asking the committee to support the agencies' move to implement healthier capital levels for Americas' banks. We ask that the committee also urge them to move forward swiftly with updates to their merger guidelines and incentive compensation rules, as well as continue with the integration of climate risk into their supervisory strategies and tools. Thank you for the opportunity to make this statement for the record.